insightpaper

AMP CAPITAL

JULY 2015

PRESERVING YIELD GETS HARDER

The Reserve Bank of New Zealand (RBNZ) cut interest rates to 3.0% today. This means earning a decent income from traditional saving vehicles just got even harder. In an increasingly low yield world, what are the options for yield-oriented investors?

GLOBAL BOND YIELDS

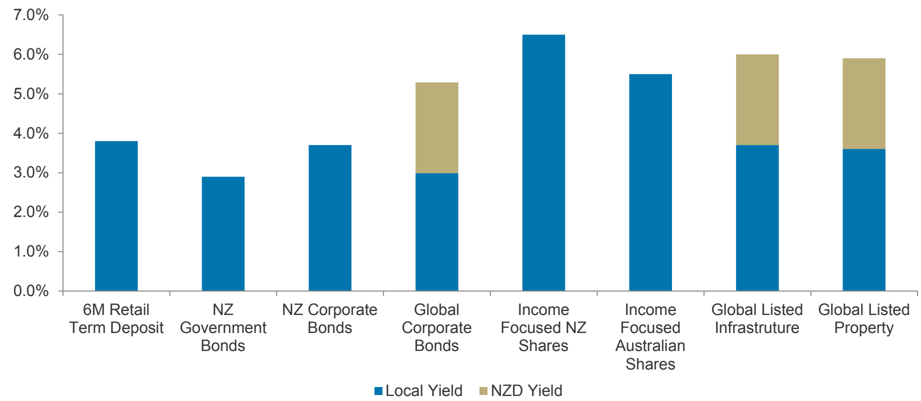
Term deposits and domestic bond yields have turned down over the last six months as the RBNZ has moved from a tightening bias to full on easing mode. This emphasises again the need to look further afield for yield as global corporate bond yields have not declined as much as local yields.

With the US Federal Reserve (the Fed) reiterating it is on course to raise rates this year and economic growth improving in Europe, global bond yields are higher than at the start of the year.

KEITH POORE

Head of Investment Strategy

INDICATIVE YIELDS



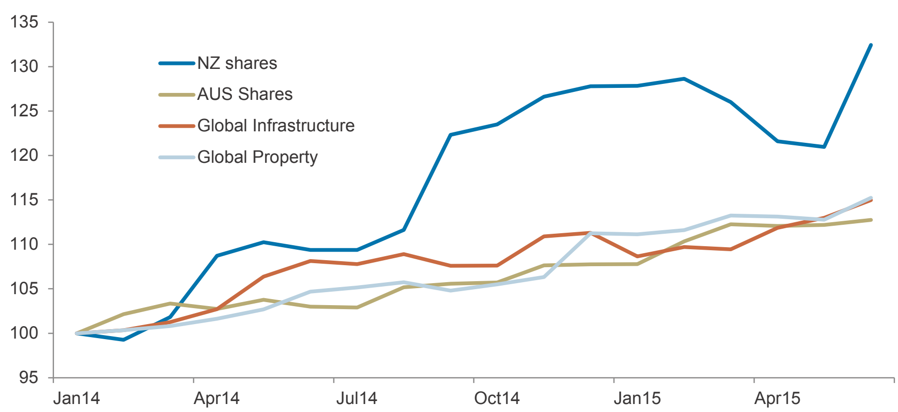
Source: AMP Capital

The New Zealand dollar hedging carry is expected to decline on global bonds, as the RBNZ cuts rates further and the Fed starts to raise rates. But even accounting for this, there is still quite a gap between domestic and offshore bond yields.

DIVIDEND YIELDS

Yields have also remained healthy on income focused shares because dividend growth, especially for domestic shares, has been strong over the last year.

12 MONTH CASH DIVIDEND PER SHARE (Jan 2014 = 100)



Source: Bloomberg, AMP Capital

Besides higher yields, a rising income stream is another benefit from investing in 'real' assets such as shares versus 'nominal' assets such as bonds.

We would expect dividends to grow at least with inflation over time because if a company's revenues and costs both rise with inflation, then so will earnings and dividends assuming no change in pay-out ratios. Dividend growth has been much higher than inflation recently because earnings have grown along with solid GDP growth and companies have lifted dividend pay outs.

Of course, price volatility and the risk of capital loss increases as you move from cash and fixed interest to listed shares. This is the case even for income focused shares which are often characterised as 'defensive' because they generally have high and stable cash flows plus lower valuations than the broader share market.

DIVERSIFICATION IS KEY

Diversifying a portfolio across these higher yield sources will help reduce price volatility but not remove it. Therefore a higher weighting to defensive income assets, such as cash and investment grade corporate bonds, is still required if high volatility cannot be tolerated. But in a low yield world, income focused shares have an important role to play for yield oriented investors.

CONTACT US

If you would like to know more about how AMP Capital can help you, please visit **www.ampcapital.co.nz**

© Copyright 2015 AMP Capital Investors Limited. All rights reserved.